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DEPT FOR WHA/EPSC FAITH CORNEILLE

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TAGS: EPET EINV ENRG ECON PREL EC
SUBJECT: GOE CLAIMS 99 PERCENT SHARE OF EXTRAORDINARY
PETROLEUM REVENUES

REF: 06 QUITO 1722

Classified By: Ambassador Linda Jewell, Reasons 1.4(b) and (d)

¶1. (C) Summary: Ecuadorian President Correa issued a presidential decree late October 4 increasing the State's share to 99 percent of "extraordinary" petroleum revenues produced by private companies. Petroleum operators claim the decree is a complete surprise and contrary to assurances of amicable, equitable contract renegotiations from the Minister of Petroleum and Mines. The GOE hopes to recover USD 700 million per year from the new arrangement. End Summary.

¶2. (U) In a surprise move late on October 4, Ecuadorian President Correa issued a presidential decree that dramatically increases the State's share of extraordinary petroleum revenues. The government's take had already been increased in 2006 by a controversial law, promulgated by former President Palacio, that increased the State's share of petroleum revenues to "at least 50 percent of extraordinary revenues" (reftel). Correa's decree raises the State's share to 99 percent. According to the press, the GOE hopes to collect USD 700 million per year with this arrangement.

Background on Previous Revenue Sharing Requirement
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¶3. (U) Extraordinary revenues are defined as the difference between current prices and the historical price that was in effect at the time the company's contract was signed, adjusted for U.S. inflation. The provision applies to production sharing contracts, where the State and company agree to share a portion of oil production, but the company benefits if oil prices rise (and bears the risk if prices fall). It does not apply to other types of contracts, such as a service production contracts or contracts to manage small fields.

¶4. (SBU) After the Palacio administration issued implementing regulations, private oil companies were required to share 50 percent of extraordinary revenue with the State, although neither the Palacio nor Correa administrations have renegotiated the production sharing contracts to reflect the new requirement. Most foreign oil companies complied with the provision, but U.S.-owned oil company City Oriente

deposited its required payments in an off-shore account rather than transferring the funds to the government. It also filed for international arbitration over the issue.

Complete Surprise for Foreign Oil Companies

¶5. (C) Correa's decree came as a complete surprise to foreign oil companies, who report they received assurances in a group meeting October 2 from Petroleum and Mining Minister Chiriboga that the GOE wanted amicable, equitable, and "win-win" contract renegotiations. Chiriboga reportedly told the firms not to believe rumors about nationalization, and planned a joint press conference with them for Monday October 8 to highlight cooperation. Five petroleum companies - Chinese-owned Andes Petroleum (the largest petroleum operator in Ecuador), Spanish-owned Repsol YPF, Brazilian-owned Petrobras, French-owned Perenco, and U.S.-owned City Oriente had apparently already set up meetings to discuss contract renegotiations based on Chiriboga's assurances. (Of this group, City Oriente is the smallest company, producing around 3,000 barrels per day.)

¶6. (C) Petroleum companies called an emergency meeting the morning of October 5 to discuss how to deal with the new decree. According to Kyle Ford of City Oriente, all foreign oil companies would record losses under the new 99 percent revenue sharing requirement. One press article reports Minister Chiriboga as welcoming discussion with oil companies on the possibility of converting to services contracts (where firms would only be paid for services rendered) rather than production sharing contracts. Ford notes that his company had considered this option in the past (provided that any new contract allowed for City Oriente to recover its investment),

but would be hard-pressed to do so now while being "coerced" by the GOE. He also commented that he did not think many firms would agree to services contracts as most are subject to "ship or pay" commitments to the new heavy crude pipeline (OCP), and would still be required to pay even if they were no longer shipping oil. Nevertheless, firms plan to consult with their headquarters before taking any action.

¶7. (C) Comment: Kyle Ford believes President Correa decided on the 99 percent sharing requirement without input from Petroleum Minister Chiriboga. Given what we know of Correa's decision-making style, we consider it likely that he made this decision without consulting with the Petroleum Ministry, the Foreign Ministry, or other stakeholders, and that the extent of possible consequences to this action was not fully considered (for example, the decision was announced in the middle of a visit by Brazilian Foreign Minister Celso Amorim). Therefore we suspect that the GOE is now scrambling to determine how to implement this measure, and might seek to do so in ways that could be acceptable to the affected companies (such as Chiriboga's suggestion to migrate to a different type of contract). Given this, it is unclear how the situation will develop. We suggest that the USG not take a public position on this matter while the GOE and affected companies are considering how to respond to this development. In the interim, we will remain in touch with City Oriente, seek clarification from the GOE, and consult with other embassies that are representing the larger petroleum investors. End Comment.
JEWELL